PROFESSIONAL ADVISOR UPDATE

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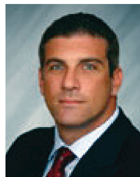

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# I will gladly pay you Tuesday …

Even though J. Wellington Wimpy first started saying it in 1932, he was still uttering his famous catchphrase in Popeye cartoons when I was a kid, "I will gladly pay you Tuesday for a hamburger today." As I recall, Wimpy's offer was always patently insincere, and anyone foolish enough to accept his offer should not have been surprised that, come Tuesday, Wimpy wasn't really ready to pay.

These days, J. Wellington Wimpy would be right at home as an employer offering Non-Qualified Deferred Compensation (NQDC) plans to his employees. Of course, he would appreciate the value of offering a plan to key employees that increases their ties to his business over the long term. No doubt he would also be gratified that he has a great deal of flexibility in the design and funding of the plan, and I'm sure he would be overjoyed that properly designed NQDC plans escape most of ERISA's burdensome requirements.

But what would really get old J. Wellington humming a happy tune is recognizing what a Non-Qualified Deferred Compensation plan fundamentally is: an employer's promise to pay later for services an employee performs now. What's more, the rules of §409(A) require that the promise remain subject to a substantial risk of forfeiture until vested, and that the promise not be backed with specific assets. "I will gladly make you an unsecured and unfunded promise to pay you Tuesday for a hamburger today."

When working with employees being offered a NQDC plan, advisors should be careful to explain the risks of the plan as well as the potential benefits. The most significant category of risk may be the risk that the promised benefit payments won't be paid. The most obvious example, of course, is that the employer is financially unable to make the promised payments; a NQDC plan participant should have a great deal of confidence in the ability of management to maintain the business's viability over the long term. A less appreciated example is the potential that the employer will refuse to make good on the promise.

If employees were being offered such plans by the likes of Mr. Wimpy, there would certainly be far fewer plans being implemented. Most employers, though, are serious, credible people; plus, a NQDC plan creates a contractual obligation of the employer to pay. So, employees may not even consider the possibility that their employer would try to renege. Yet court cases in recent years make clear that J. Wellington Wimpy's brethren are still among us. Here are just two …

*Gardner v. Heartland*

In August 2006, Heartland Industrial Partners agreed to sell its interest in Metaldyne Corporation to Ripplewood Holdings. Accordingly, Metaldyne submitted a required information report to the SEC detailing the terms of the acquisition. That report failed to mention that Metaldyne would owe approximately $13 million to five participants in Metaldyne's Supplemental Executive Retirement Plan as a result of a change-of-control provision in that SERP.

When Ripplewood threatened to back out of the deal upon learning of the $13mm SERP obligation, Metaldyne's Board took action in December 2006 to declare the SERP invalid … although Metaldyne did not notify the SERP's participants of its action until a month after the deal had closed. The participants are currently suing in Michigan state court.

*Cramer v. Appalachian Regional Healthcare*

Mr. Cramer worked for Appalachian Regional Healthcare from 1981 until 2008. In 1994, Cramer was promoted and became eligible for ARH's SERP which was created in 1986. The 1986 SERP defined years of service to include all years in which the participant was employed at ARH. Cramer retired/resigned from ARH in 2007 at age 49, and under the 1986 SERP's years of service calculation, was entitled to receive a monthly benefit of $1,009.34.

On December 31, 2008, ARH adopted an Amendment and Restatement of the SERP. The 2008 SERP changed the years of service definition to include only the years an employee was eligible for SERP, not the years an employee was employed by ARH but ineligible for SERP. Under the 2008 SERP, Cramer would not receive any SERP benefits. In 2010, after an administrative review, the SERP Committee denied Cramer's appeal and held that the 2008 SERP governed his benefits. Cramer subsequently filed several ERISA-based claims against ARH in federal district court; however, the court found the SERP to fall within the "top hat" exemption and thus not subject to the ERISA sections on which Cramer's claims were based.

As advisors helping to facilitate the implementation of a NQDC plan, we have an obligation to explain clearly to employers the nature of the contractual obligation they're making, as well as explaining the inherent risks to participants. We can also help employers reduce the potential of future disputes with employees by encouraging them to:

- Communicate the NQDC plan's provisions clearly and transparently – be especially clear regarding the operation of any change-of-control provision
- Include strong "successor" language in the plan agreement. For example, include a requirement that "no merger, sale or other transaction, including a sale of assets, may occur without the acquiring or surviving company agreeing to assume the plan"
- Include clear amendment and termination language in the plan agreement. In particular, include provisions addressing who has authority to amend or terminate the plan, and whether amendments may reduce or eliminate participant benefits without participant approval
- Include detailed claims procedures in the plan agreement
- Consider using a rabbi trust to hold plan funds apart from the company's general assets (though still subject to claims of the company's general creditors in the event of its insolvency)

**For questions or comments please contact 855-LIFEAUDIT (855-543-3283)**

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